

Message Text

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FM AMEMBASSY CAIRO
TO SECSTATE WASHDC PRIORITY 7705

C O N F I D E N T I A L SECTION 01 OF 03 CAIRO 10247

PASS AID

E.O. 11652:GDS
TAGS:EFIN, EAID, EG
SUBJECT: IMF-GOE NEGOTIATIONS

SUMMARY: MINISTER OF FINANCE GAVE USAID DIRECTOR COPIES OF RECENT KAISSOUNI/IMF CABLE EXCHANGE ON NEGOTIATION OF EXTENDED FUND FACILITY. MINISTER EXPRESSED HOPE THAT USG WOULD BE ABLE TO URGE IMF TO AGREE TO GOE POSITIONS. THIS ' CABLE GIVES TEXT OF CABLES. OUR COMMENT WILL BE PROVIDED IN SEPARATE CABLE.

1. CABLE OF MARCH 16 FROM WILLIAM DALE, ACTING MANAGING DIRECTOR OF IMF TO KAISSOUNI QUOTE:

THE STAFF MISSION RECENTLY IN CAIRO HAS REPORTED TO THE MANAGING DIRECTOR AND MYSELF THE RESULTS OF THEIR DISCUSSIONS WITH YOU, AND THE REMAINING POINTS OF DIFFERENCE BETWEEN THE STAFF AND THE EGYPTIAN AUTHORITIES. I AM SENDING THIS MESSAGE IN THE ABSENCE OF THE MANAGING DIRECTOR BUT WITH THE BENEFIT OF CONSULTATION WITH HIM BEFORE HE LEFT WASHINGTON.

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THE MANAGING DIRECTOR AND I ARE ENCOURAGED BY THE PROGRESS THAT HAS BEEN MADE SO FAR IN IMPLEMENTING REFORMS AIMED AT STRENGTHENING THE DOMESTIC AND EXTERNAL FINANCIAL POSITIONS. WE FULLY APPRECIATE THE DIFFICULTIES ASSOCIATED WITH MAINTAINING THE MOMENTUM OF REFORM, BUT WE BELIEVE THAT UNDUE DELAY IN IMPLEMENTING THE FURTHER MEASURES REGARDED AS NECESSARY BY THE EGYPTIAN AUTHORITIES AND THE

STAFF WILL ONLY LEAD TO THE AGGRAVATION OF THE UNDERLYING PROBLEMS AND RENDER IT INCREASINGLY DIFFICULT TO TAKE CORRECTIVE MEASURES.

WE TRUST THAT AGREEMENT CAN BE REACHED ON A THREE-YEAR PROGRAM OF ECONOMIC REFORM THAT MEETS THE REQUIREMENTS OF THE EXECUTIVE BOARD DECISION ON THE EXTENDED FUND FACILITY, WHILE RECOGNIZING THE PARTICULAR ECONOMIC, SOCIAL AND POLITICAL CIRCUMSTANCES IN EGYPT. AS YOU ARE AWARE, UNDER THAT DECISION A PROGRAM SUPPORTED BY AN EXTENDED ARRANGEMENT MUST INCLUDE MEASURES FOR THE FIRST YEAR THAT REPRESENT A SUBSTANTIAL INITIATION OF THE POLICIES AND MEASURES PLANNED FOR THE THREE-YEAR PERIOD. THE PROPOSALS PRESENTED BY THE STAFF DURING THE RECENT MISSION IN CAIRO WERE DESIGNED TO MEET THIS REQUIREMENT. NEVERTHELESS, IN VIEW OF THE PARTICULAR SENSITIVITY OF PRICE ADJUSTMENTS AT THE PRESENT TIME, WE WOULD BE PREPARED TO ACCEPT AND RECOMMEND FOR BOARD APPROVAL SOME CHANGE IN THE TIMING OF IMPLEMENTATION OF THE PRICING MEASURES RECOMMENDED BY THE MISSION.

THE ESSENTIAL ELEMENTS OF THE FIRST YEAR OF A PROGRAM SUPPORTED BY AN EXTENDED ARRANGEMENT WOULD THEN BE AS FOLLOWS:

(1) IN ADDITION TO THE LE 107 MILLION OF PRICE ADJUSTMENTS
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ALREADY INTRODUCED, AND THE ADDITIONAL LE 50 MILLION YOU AGREED TO IMPLEMENT PRIOR TO THE ENTRY INTO EFFECT OF THE EXTENDED ARRANGEMENT, THE EGYPTIAN AUTHORITIES WOULD MAKE APPROXIMATELY HALF OF THE FURTHER LE 150 MILLION OF PRICE ADJUSTMENTS RECOMMENDED BY THE MISSION DURING THE FIRST YEAR OF THE PROGRAM. THE REMAINDER OF THE LE 150 MILLION OF PRICE ADJUSTMENTS WOULD TAKE PLACE DURING THE FIRST QUARTER OF THE SECOND YEAR OF THE PROGRAM. IN PROPOSING THIS TIMING CHANGE WE ARE ASSUMING THAT FURTHER POLICY ADJUSTMENTS INTENDED TO STRENGTHEN THE FINANCIAL POSITION OF THE PUBLIC SECTOR WOULD TAKE PLACE IN THE SECOND YEAR OF THE PROGRAM. IN PARTICULAR, CONTINUING PRICE ADJUSTMENTS WOULD BE MADE, WHERE NECESSARY, TO REFLECT INCREASES IN COSTS OF PRODUCTION THAT MAY OCCUR DURING THE FIRST YEAR OF THE PROGRAM. THE STAFF HAS REPORTED TO US YOUR CONCERN ABOUT POSSIBLE PUBLIC MISUNDERSTANDING OF THE IMPACT OF THE NEEDED PRICE ADJUSTMENTS. IN THIS REGARD, I MIGHT POINT OUT THAT THE STAFF DOCUMENTATION FOR THE EXTENDED ARRANGEMENT COULD BE DRAWN UP IN SUCH A WAY AS TO TAKE THIS CONCERN INTO ACCOUNT.

(II) SINCE A PRINCIPAL OBJECTIVE IS THE ACHIEVEMENT AND MAINTENANCE OF AN APPROPRIATE STRUCTURE OF RELATIVE PRICES,

FLEXIBLE PRICING AND DECENTRALIZATION OF DECISION MAKING WOULD BE AN IMPORTANT PART OF A PROGRAM OF REFORM. IN LINE WITH THE INTENTION EXPRESSED IN YOUR TELEX OF JANUARY 29, 1978 TO MR. AL-ATRASH, WHICH WAS MADE AVAILABLE TO US AND WAS READ TO THE EXECUTIVE BOARD, FURTHER PROGRESS WOULD BE MADE IN REMOVING ITEMS FROM THE "LIST OF 88." THE OBJECTIVE WOULD BE TO LIMIT THE LIST TO ONLY ITEMS WHOSE PRICES HAVE A MAJOR IMPACT ON THE COST OF LIVING OF LOWER INCOME GROUPS. PRICE ADJUSTMENTS FOR COMMODITIES NOT SUBJECT TO PRICE CONTROL WOULD, OF COURSE, COUNT TOWARD THE PRICING OBJECTIVES DESCRIBED ABOVE.

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(III) IN ORDER TO PROVIDE AN ADEQUATE INCENTIVE FOR THE CONVERSION OF FOREIGN EXCHANGE BALANCES INTO EGYPTIAN POUNDS, AND THUS EASE FOREIGN EXCHANGE CONSTRAINTS, INTEREST RATES WOULD BE RAISED (GARBLE), IF NECESSARY IN TWO STAGES, BUT WITH THE FULL INCREASE TO BE IN EFFECT BY THE END OF 1978.

(IV) UNIFICATION OF THE OFFICIAL AND PARALLEL EXCHANGE MARKETS FOR TRANSACTIONS WITH MEMBER COUNTRIES WOULD TAKE PLACE BY JANUARY 1, 1979. MEANWHILE, AS AGREED WITH THE MISSION IN CAIRO, FURTHER TRANSACTIONS WOULD BE TRANSFERRED FROM THE OFFICIAL TO THE PARALLEL RATE, AND THERE WOULD BE A SUBSTANTIAL EXPANSION OF THE OPEN GENERAL LICENSE SYSTEM.

CONCERNING THE SECOND AND THIRD YEARS OF THE PROGRAM, THE MANAGING DIRECTOR AND I SHARE WITH YOU THE VIEW THAT IMPLEMENTATION OF THE GOVERNMENT'S PRESENT POLICY

INTENTIONS WILL LEAD TO A SIGNIFICANT IMPROVEMENT IN ECONOMIC PERFORMANCE IN EGYPT. THE PROGRAM TO BE SUPPORTED BY AN EXTENDED ARRANGEMENT WOULD SET OUT, INsofar AS POSSIBLE IN QUANTITATIVE TERMS, THE POLICIES THAT WOULD BE PURSUED IN THE SECOND AND THIRD YEARS TO ACHIEVE THE

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GOVERNMENT'S OBJECTIVES, THE MOST IMPORTANT OF WHICH ARE ATTAINING A SUSTAINABLE BALANCE OF PAYMENTS POSITION, IMPROVING THE BALANCE BETWEEN CONSUMPTION AND INVESTMENT IN THE ECONOMY, AND RESTORING DOMESTIC FINANCIAL STABILITY. IN OUR JUDGMENT, THE PROPOSALS FOR THE SECOND AND THIRD YEARS OF THE PROGRAM PRESENTED TO YOU BY THE STAFF MISSION IN THEIR MEMORANDUM OF FEBRUARY 24, 1978 PROVIDE AN APPROPRIATE BASIS FOR ACHIEVING THE GOVERNMENT'S OBJECTIVES. WE SINCERELY HOPE THAT THE ABOVE WILL BE A BASIS ON WHICH A PROGRAM CAN BE WORKED OUT. IF SO, A MISSION COULD VISIT CAIRO EARLY IN APRIL TO WORK OUT THE DETAILS OF THE PROGRAM AND FORMULATE APPROPRIATE CREDIT AND EXTERNAL DEBT CEILINGSS MR. GERHARD WILL BE IN CONTACT WITH YOU REGARDING THESE PROPOSALS, TO WHICH YOUR EARLY RESPONSE WILL BE GREATLY APPRECIATED. WITH HIGHEST REGARDS. DALE, ACTING MANAGING DIRECTOR, INTERFUND. UNQUOTE.

2. CABLE OF MARCH 23 FROM KAISOUNI TO DALE, DEPUTY MANAGER, IMF. QUOTE I THANK YOU FOR YOUR CABLE OF MARCH 16TH AND I APPRECIATE YOUR PROPOSALS REGARDING A CONSTRUCTIVE SOLUTION. I CONSIDER THAT THE IMF AND THE EGYPTIAN GOVERNMENT HAVE ALREADY REACHED AN UNDERSTANDING ON ALMOST ALL SUBJECTS. HOWEVER, ON THE QUESTION OF PRICES I SINCERELY BELIEVE THAT THE ACTION REQUIRED FROM THE GOVERNMENT IS BEYOND THE LIMITS OF WISDOM AS WELL AS POLITICAL AND SOCIAL STABILITY. THE ACTION TAKEN SO FAR IS ALREADY CAUSING A GREAT DEAL OF CONTROVERSY IN CABINET, PARLIAMENT AND AMONG THE PEOPLE. A STRONGER DOSE WOULD ENHANCE THE DIFFERENCES AT A TIME WHEN WE REQUIRE UNITY AND STABILITY IN ORDER TO ACHIEVE OUR DEVELOPMENT PLANS.

PERHAPS ON THE BASIS OF THE FACT THAT I HAVE THE DOUBLE PRIVILEGE OF BEING A MEMBER OF THE GOVERNMENT AND AN OLD

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MEMBER (SIC) OF THE STAFF OF THE I.M.F. I CAN ALLOW MYSELF AND ADVISE MORE UNDERSTANDING AND FLEXIBILITY ON THIS ISSUE.

OUR COMMITMENT TO THE RATIONAL ADJUSTMENT OF PRICES REMAINS
UNCHANGED AND WE DO NOT DIFFER WITH THE I.M.F. ON THE
NECESSITY FOR SUCH A POLICY. HOWEVER, ON THE BASIS OF MY
ESTIMATES OF THE PREVAILING CONDITIONS I WOULD RECOMMEND
A MORE GRADUAL APPROACH. SINCERELY, A.M. KAISOUNI.
UNQUOTE

3. CABLE OF MARCH 24 FROM DALE, DEPUTY MANAGING DIRECTOR
TO KAISOUNI. QUOTE THANK YOU FOR YOUR CABLE SETTING OUT
FRANKLY THE DIFFICULTIES YOU SEE IN IMPLEMENTING THE PRICE
ADJUSTMENTS PROPOSED IN MY CABLE OF MARCH 16TH. I HAVE
DISCUSSED THIS WITH THE MANAGING DIRECTOR, AND WE HAVE
ALSO HAD THE BENEFIT OF A MEETING WITH THE AMBASSADOR OF
EGYPT TO THE UNITED STATES. WE HAVE TAKEN FULL ACCOUNT
OF THE POINTS RAISED IN YOUR CABLE, AND MADE BY THE
AMBASSADOR, BUT WE FEEL THAT ANY WEAKENING OF THE MEASURE
PROPOSED IN MY CABLE WOULD BE INCONSISTENT WITH THE
DECISION OF THE EXECUTIVE BOARD ON THE EXTENDED FUND
FACILITY.

THE DECISION ESTABLISHING THE EXTENDED FUND FACILITY
REQUIRES THAT THE PROGRAM OF MEASURES ADOPTED IN THE
FIRST YEAR OF AN ARRANGEMENT REPRESENTS A 'SUBSTANTIAL
INITIATION' OF THE POLICIES AND MEASURES FOR THE THREE-
YEAR PERIOD AS A WHOLE, TAKING INTO ACCOUNT THE
CIRCUMSTANCES OF THE MEMBER. THE PRICE ADJUSTMENTS WHICH
YOU HAVE PROPOSED TO IMPLEMENT BEFORE ENTERING INTO AN
EXTENDED ARRANGEMENT REPRESENT A COURAGEOUS FIRST STEP,
WHICH WE COMMEND. NEVERTHELESS, BEARING IN MIND THE

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FM AMEMBASSY CAIRO

TO SECSTATE WASHDC PRIORITY 7707

C O N F I D E N T I A L SECTION 03 OF 03 CAIRO 10247

IMPORTANCE OF RESTORING A RATIONAL STRUCTURE OF PRICES,

AND STRENGTHENING THE FINANCIAL POSITION OF THE PUBLIC SECTOR, FURTHER ACTION DURING THE FIRST 12 MONTHS OF THE PROGRAM PERIOD IS NECESSARY TO MEET THE ESSENTIAL CONDITIONS OF THE EXTENDED FACILITY. IN VIEW OF YOUR SOCIAL AND POLITICAL DIFFICULTIES, I HAD SUGGESTED IN MY CABLE A CHANGE IN THE TIMING OF IMPLEMENTATION OF PRICING MEASURES RECOMMENDED BY THE MISSION. FURTHER DELAY IN IMPLEMENTING PRICE ADJUSTMENTS IN PUBLIC SECTOR OUTPUT WOULD ADD TO THE FISCAL DEFICIT AND INCREASE THE RATE OF CREDIT CREATION IN THE DOMESTIC ECONOMY. THIS WOULD INTENSIFY INFLATIONARY PRESSURES AND GIVE RISE TO CONTINUING PRICE INCREASES FOR GOODS AND SERVICES NOT SUBJECT TO PRICE CONTROL, MAKING THE TASK OF EVENTUAL PRICE ADJUSTMENT EVEN MORE DIFFICULT.

I SINCERELY HOPE THAT AGREEMENT CAN BE REACHED ON THE BASIS OF A PROGRAM THAT GIVES ADEQUATE ASSURANCE OF STEADY PROGRESS TOWARD THE MEDIUM-TERM GOALS WHICH THE EGYPTIAN GOVERNMENT HAS SET, AND WHICH THE FUND STAFF ENDORSES. IF, HOWEVER, YOU FEEL THAT THE GOVERNMENT CANNOT COMMIT ITSELF TO MEASURES ALONG THE LINES INDICATED IN MY CABLE, I SUGGEST THAT WE ATTEMPT INSTEAD TO REACH AGREEMENT FOR A ONE-YEAR STAND-BY, ON THE BASIS OF THE MEASURES IN THE

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PRICING FIELD WHICH YOU PROPOSE TO TAKE AND THE MEASURES INDICATED IN PARAGRAPHS (II), (III) AND (IV) OF MY CABLE. SUCH AN APPROACH WOULD HAVE THE ADVANTAGE OF MAINTAINING THE FINANCIAL RELATIONSHIP BETWEEN EGYPT AND THE FUND, WHILE ALLOWING FOR FURTHER DISCUSSIONS TO TAKE PLACE ON A MEDIUM-TERM PROGRAM TO BE ADOPTED AT A LATER DATE. WITH HIGHEST REGARDS, WILLIAM B. DALE, DEPUTY MANAGING DIRECTOR, INTERFUND. UNQUOTE. EILTS

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